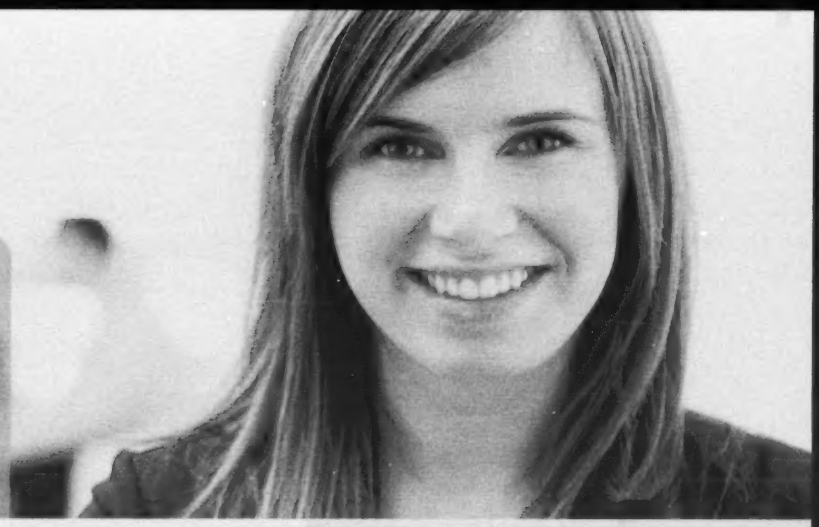
BDC
Entrepreneurs first

economic LETTER

JANUARY 2016



Highlights of the month:

> Canadian economic growth was weaker than expected in 2015. The collapse of oil prices curtailed economic activity considerably, and the depreciation of the loonie failed to stimulate net exports to a sufficient degree. The outlook for 2016 is better: growth should remain modest, but will gradually accelerate during the year.

> Business confidence flagged markedly in Alberta in 2015, but remained relatively stable in the other provinces. It should firm up gradually during the course of the year, as the Canadian economy gathers steam.

> The loonie depreciated further in December. Over the course of 2015, it lost 16% of its value against the U.S. dollar. This depreciation, combined with the strengthening of the U.S. economy, should benefit Canadian exporters in 2016.

Canada
- The gross domestic product remains flat
- Employment rebounds
- Housing starts and home sales are up
- Exports edge up

United States
- Job growth remains robust
- Housing starts rise, but home sales pull back
- Business confidence slips while consumer confidence remains firm

Interest rates
No key interest rate hike anticipated before the end of the year

Oil price

Canadian dollar

SME confidence

Credit conditions

Key indicators

THE CANADIAN ECONOMY IN 2016: GROWTH SHOULD ACCELERATE, BUT WILL REMAIN MODEST

Before we take a peek at what 2016 has in store for us, let's first take a look at expectations at the start of last year, and consider the extent to which they came to fruition. In January 2015, forecasters were anticipating 2.3% real GDP growth in Canada.[1] However, the data from the first three quarters of the year led them to downgrade their forecasts significantly, and they now expect growth to come in at just 1.2%.[2]

The decline in investments was underestimated while the increase in exports was overestimated in 2015

Forecasters were expecting the plunge in oil prices to generate a pullback in business investment. That is indeed what happened, but the extent of the pullback was underestimated. They also predicted that the negative impact of the oil price slump would be partly offset by an increase in exports of non-energy products, stimulated by U.S. demand and by the depreciation of the Canadian dollar. Those exports were overestimated. It should be pointed out that U.S. economic activity was weaker than anticipated in 2015: real GDP growth will probably turn out to be in the neighbourhood of 2.5%, whereas the forecasts at the beginning of the year put it at 3.2%. ▼

1 *Consensus Forecasts*, January 12, 2015.
2 *Consensus Forecasts*, December 7, 2015.

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to January 12. Reliance on and use of this information is the reader's responsibility.

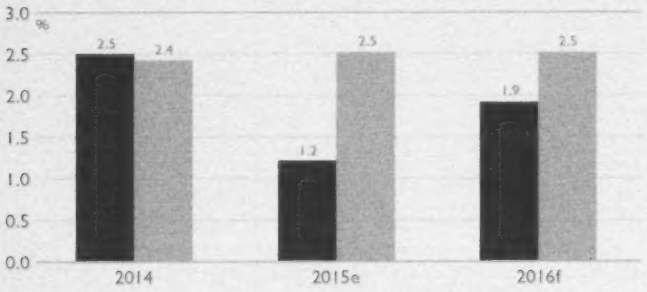
Copyright © 2016 Business Development Bank of Canada | 1 888 INFO BDC | bdc.ca

Business investment is likely to remain depressed in 2016

Canadian economic growth should accelerate, from 1.2% in 2015 to 1.9% in 2016 (graph). The forecasts for the current year vary between 1.0% and 2.4%, depending on the institution. The growth scenarios are not identical, but they have much in common. The majority of forecasters expect that business investment will remain depressed. Oil prices have continued to tumble, and the probability of them climbing back up in the near future is slim. The global supply of oil is still abundant and reserves are plentiful. Given the low prices, production should eventually taper off, but it will no doubt take several months before that generates any marked increase in prices. Consequently, investment in the oil sector is expected to decline further in 2016. Meanwhile, metal prices, which have dropped significantly in recent years due to expanding global production, will probably remain low, thereby limiting investment in the mining sector.

In 2016, economic growth should accelerate in Canada and remain strong in the United States

Annual change in real GDP



Sources: Statistics Canada and the U.S. Bureau of Economic Analysis (historical data); Consensus Forecasts December 7, 2015 (estimates and forecasts)

Growth will be supported by consumption and net exports

Forecasters are also in agreement about the fact that the main sources of growth in 2016 will be consumer spending and net exports. The household debt rate is high, but credit conditions will remain favourable to consumption. While the Federal Reserve started raising its key interest rate in December, the Bank of Canada should leave its key rate unchanged until at least the last quarter of the year.

Meanwhile, low oil prices and the rise in the U.S. key interest rate will help keep the loonie at a level that should stimulate exports and discourage imports. Canadian exports should also benefit from the vitality of the U.S. economy: forecasts for U.S. real GDP growth in 2016 are showing a fairly robust rate of 2.5%.

The contribution to growth by residential investment will likely be low, and that of public administration will be limited

The contribution to growth from residential investment was stronger than expected in 2015, but the slowdown in activity that was anticipated in the housing market last year should materialize this year. As for public administration expenditures and investments, once again we should not expect them to make a strong contribution to economic growth. The scope of the additional investments in infrastructure that were announced by the federal government is actually quite limited (between $5 and $10 billion in 2016) and most provincial governments are still restricting their spending in order to return to balanced budgets.

The downside risks appear to outweigh the upside risks to some extent

Obviously, any forecasting exercise is subject to risk. The largest downside risk has to do with the expected increase in net exports. In 2015, export growth was not as vigorous as anticipated, despite the marked depreciation of the loonie. This is partly due to the fact that, since the beginning of the 2000s, Canada's share of U.S. imports has narrowed considerably in favour of developing economies. Consequently, the loonie's depreciation has less impact on exports bound for the United States than it used to have; a phenomenon that forecasters may not yet have fully integrated into their growth scenarios.

The environment will still be favourable for investment and exports in 2016

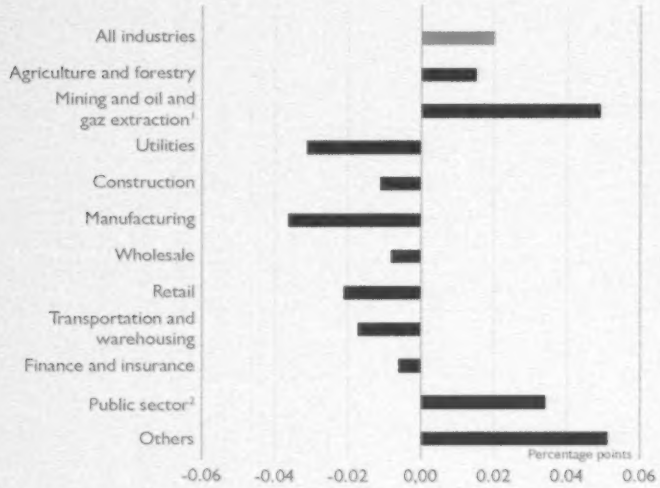
Even if economic activity accelerates in 2016, it will not be strong enough to prompt the Bank of Canada to raise its key interest rate to prevent inflation, at least not before the end of the year. And when the central bank does decide to raise interest rates, it will do so very gradually. Consequently, business leaders will continue to enjoy credit conditions that are conducive to investment this year. In addition, the strength of the U.S. economy and the weakness of the loonie against the greenback will stimulate demand for Canadian products; a situation that bodes well for exporting firms. ■

GDP remains flat

After a 0.5% contraction in September, real GDP stayed flat in October. Production declined in most of the major sectors (graph). These pullbacks were neutralized by increases in the natural resources sector (mining, gas and oil), agriculture, forestry and utilities. Manufacturing is the industry that most curtailed GDP growth, recording a second straight monthly slump. Despite the lacklustre data of September and October, real GDP growth in 2015 should come in at around 1.2%, as predicted by the Consensus.

The majority of the main industries made negative contributions to growth in October

Contributions by the main sectors to the percentage change in Canadian real GDP in October 2015



1 Includes quarrying
2 Education, health and public administration

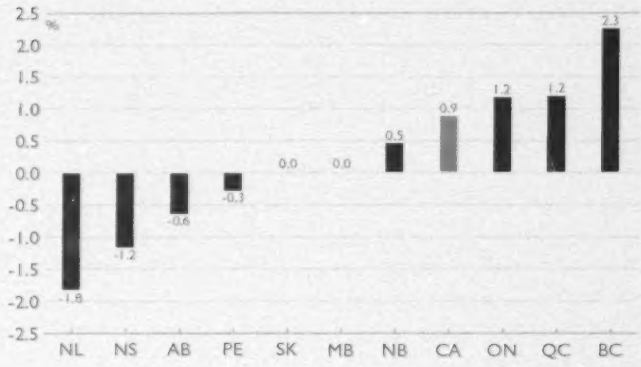
Source: Statistics Canada

Employment rebounds

After a pullback of 35,700 in November, employment grew by 22,800 in December. The unemployment rate held steady at 7.1%. The final tally for 2015 is slightly better than that of the previous year. Between December 2014 and December 2015, employment expanded by 158,100, an increase of 0.9%, compared with an increase of 0.7% between December 2013 and December 2014. It was mainly full-time employment that increased in 2015 (1.0%), while part-time employment remained practically flat (0.2%). Looking at the provinces, it was British Columbia that came came out on top, with 2.3% job growth, followed by Ontario and Quebec which recorded gains of 1.2% (graph). The oil price slump resulted in job losses in Newfoundland and Labrador and in Alberta.

British Columbia recorded the strongest job growth in 2015

Change in employment between December 2014 and December 2015, by province



Source: Statistics Canada

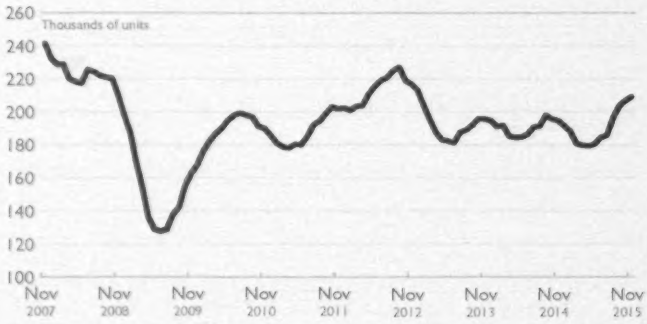
The aging of the population is reflected in the numbers: in 2015, employment expanded only in the 55-and-over age group (by 6.3%). It fell by 1.9% among those aged 15 to 24, and remained practically unchanged among those aged 25 to 54 (-0.1%).

Housing starts and home sales are up

Housing starts, which had tumbled by 15.1% in October, rose by 7.2% in November compared with the previous month. The housing start trend, measured in terms of the six-month moving average, is up for the seventh month in a row (graph). This upturn is attributable to multiple-unit housing, demand for which is being stimulated by the rising prices of single-family homes, according to the Canada Mortgage and Housing Corporation. As for home sales, they ticked up by 1.8% in November, reaching their highest monthly peak in six years. According to the Canadian Real Estate Association, the new rule that increases the minimum down payment ▼

The housing start trend is up for the seventh straight month

Six-month moving average of housing starts, Canada



Source: Statistics Canada

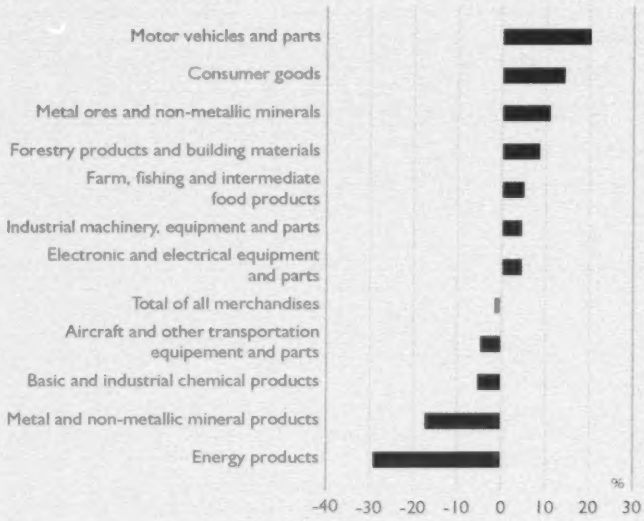
on insured mortgage for the portion of the selling price that exceeds $500,000, from 5% to 10%, is probably having the effect of accelerating sales in the short term, as buyers are rushing to complete their purchases before it comes into force, in February 2016.

Exports edge up

Exports ticked up by 0.4% in November while imports fell by 0.7%. These movements resulted in a narrowing of the trade deficit, from $2.5 billion in October to $2.0 billion in November. Exports bound for the United States rose by 1.3%. Since the beginning of the year, Canadian exports have declined by 1.4%, but this weakness is mainly attributable to energy products and metals (graph). Exports of motor vehicles and consumer goods, among other things, increased considerably in 2015. ■

The sluggishness of exports is mainly attributable to energy and metals

Change in Canadian exports from December 2014 to November 2015, by product


Motor vehicles and parts
Consumer goods
Metal ores and non-metallic minerals
Forestry products and building materials
Farm, fishing and intermediate food products
Industrial machinery, equipment and parts
Electronic and electrical equipment and parts
Total of all merchandises
Aircraft and other transportation equipement and parts
Basic and industrial chemical products
Metal and non-metallic mineral products
Energy products
%
-40 -30 -20 -10 0 10 20 30

Source: Statistics Canada

★ UNITED STATES

Back

Job growth remains robust

The job market expanded by 292,000 in December and the unemployment rate remained stable at 5.0%. Even though total job growth deteriorated slightly in 2015 compared with the previous year, it was still excellent. Employment grew by 1.9% between December 2014 and December 2015, and the unemployment rate fell by 0.6 percentage points. By comparison, between December 2013 and December 2014, employment grew by 2.3% and the unemployment rate fell by 1.1 percentage points. Several indicators show that the state of the labour market continued to improve in 2015. The number of discouraged workers (those who had withdrawn from the labour market because they were convinced they would not find work) dropped by 10.4% between December 2014 and December 2015; the number of people working part time for economic reasons (who would prefer to work full time) and the number of long-term unemployed workers (27 weeks or more) tumbled by 11.3% and 24.8%, respectively, during the same period (graph).

Several indicators show improvement in the labour market

Change in certain labour market indicators between December 2014 and December 2015, United States

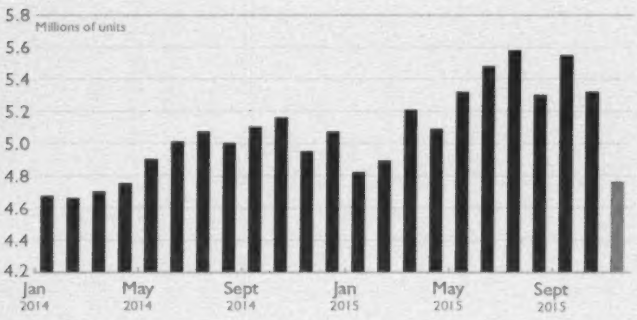
Source: U.S. Bureau of Labor Statistics

Housing starts rise, but home sales pull back

Housing starts were up by 10.5% in November compared with the previous month, and by 16.5% compared with November 2014. After a short pause in October, the housing start trend, measured by the six-month moving average, has returned to an upward path. Meanwhile, home sales were down by 10.5% in November, reaching their lowest level since April 2014. According to the National Association of Realtors in the U.S., the decline is largely due to the longer period of time that it took to carry out transactions, pushing some of them into December. This effect has to do with realtors adjusting to the Know Before You Owe initiative that was introduced by the U.S. government to better inform consumers wishing to take out a mortgage loan. ▼

In November, home sales reached their lowest level since April 2014

Home sales, United States, seasonally adjusted, annual rate



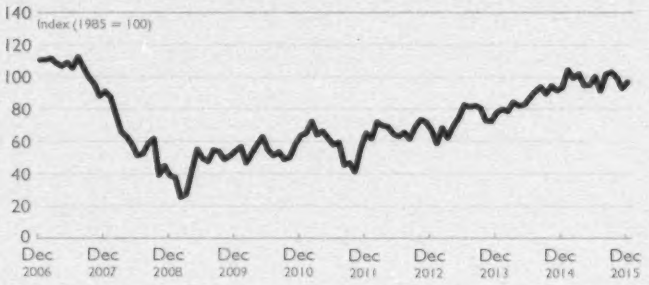
Source: U.S. National Association of Realtors

Business confidence slips while consumer confidence remains firm

Measured by the purchasing managers' index compiled by the Institute for Supply Management (ISM), business confidence is in decline. The ISM index of the manufacturing sector lost ground in November and now sits below the 50% mark for the second straight month, pointing towards possible contraction in the manufacturing sector. That said, as long as it stays above 43.1%, the index tells us that the economy as a whole is continuing to expand. Meanwhile, U.S. consumer confidence is still high, according to the U.S. Conference Board index. It has been oscillating around 98 throughout 2015 (graph). ■

Consumer confidence remains high

Consumer Confidence Index, United States



Source: U.S. Conference Board

INTEREST RATES

Back

No key interest rate hike anticipated before the end of the year

On January 20, the Bank of Canada will announce its next decision regarding the key interest rate. No forecaster is anticipating a rate hike, even though the U.S. Federal Reserve has started raising its rates. The U.S. central bank raised the federal fund target rate by 25 basis points on December 16. Due to the oil price slump, economic activity slowed considerably in Canada in 2015, whereas south of the border it remained solid. While Canadian economic growth is expected to accelerate gradually in 2016, it will likely remain modest. Consequently, it will probably not be necessary to raise the interest rate to prevent inflation before the end of the year. The majority of forecasters believe that the Bank of Canada will not raise the key interest rate before 2017 (table). ■

The majority of forecasters do not expect the key interest rate to increase before 2017

Institution	Date of the forecast	Quarter in which the increase will begin	Key interest rate at the end of that quarter
RBC	December 2015	2016 Q4	1.00%
Scotia	December 3, 2015	2017 Q1	0.75%
BMO	December 23, 2015	2017 Q1	0.75%
CIBC	December 17, 2015	2017 Q2	0.75%
Desjardins	December 21, 2015	2017 Q3	0.75%
TD	December 17, 2015	2017 Q4	0.75%
National Bank	Winter 2016	Not before 2017, but the quarter is not specified	
Laurentian Bank	December 17, 2015	Not before 2018	

OIL PRICE

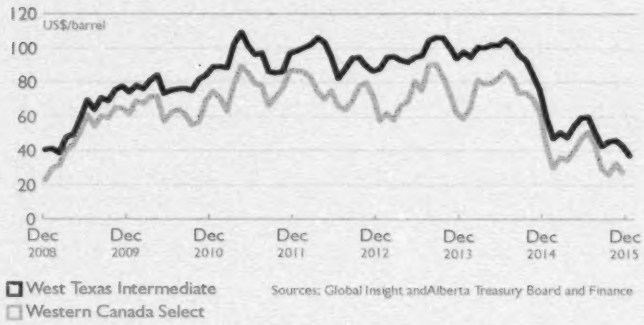
Back

Crude oil prices keep falling

The price of crude oil, measured by that of West Texas Intermediate, fell by 13.1% in December compared with the previous month. At US$37.39 in December (monthly average), it was down by 63% compared with where it was in July 2014, when it began falling. Back then, it stood at over US$100 per barrel (graph). The global market is still in a surplus supply situation, so downward pressure on prices is continuing. ■

Oil prices keep falling

Prices of West Texas Intermediate and Western Canada Select



Sources: Global Insight andAlberta Treasury Board and Finance

CANADIAN DOLLAR

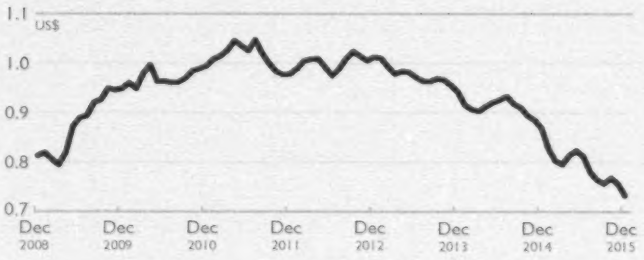
Back

The Canadian dollar depreciates further

The Canadian dollar depreciated again in December compared with the previous month (graph). The decline is partly due to the crude oil price slump during the month and partly to the raising of the federal fund target rate, which expanded the gap between U.S. and Canadian key interest rates. Between December 2014 and December 2015, the loonie lost 15.8% of its value against the greenback. ■

The Canadian dollar depreciates further

Canada/United States exchange rate



Source: Bank of Canada

SME CONFIDENCE

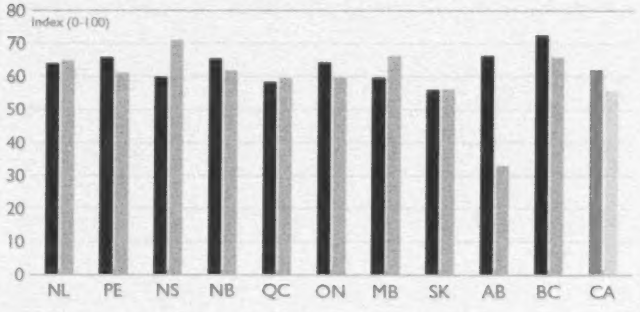
Back

The business confidence index loses ground

The Business Barometer Index compiled by the Canadian Federation of Independent Business lost 3 points in December compared with the previous month, coming in at 55.7, its lowest level since April 2009. But the deterioration of confidence in 2015 is concentrated in Alberta. It is mainly in that province that business confidence waned during the year. In the other provinces, it stayed fairly stable (graph). Alberta's confidence index is even lower than the trough it reached during the recession of 2009 (33.0 in December 2015 versus 37.4 in February 2009). ■

In 2015, business confidence deteriorated mainly in Alberta

Business Barometer, December 2014 and December 2015



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

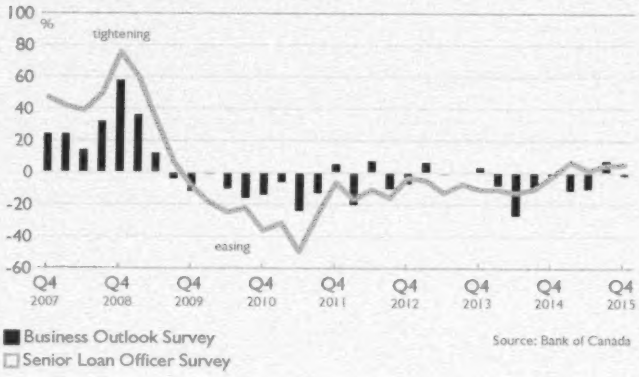
Back

In general, business credit conditions are still favourable

The data from the Senior Loan Officer Survey and the Business Outlook Survey conducted by the Bank of Canada show that, overall, business credit conditions changed very little in the fourth quarter of 2015, compared with the previous quarter. Businesses in the resources sector (particularly those in the oil and gas industries) have been experiencing tightening credit conditions in recent quarters. In the other sectors, the majority of firms report that it is fairly easy to obtain credit. ■

Little change in business credit conditions in the fourth quarter of 2015

Credit conditions, balance of opinions



Source: Bank of Canada

KEY INDICATORS—CANADA

Back

Key indicators—Canada

	Historical[1]				2015[2]				2015		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4	Latest[3]		2015	2016
Real GDP (% growth)	3.1	1.7	2.2	2.5	-0.7	-0.3	2.3		Oct	0.0	1.2	1.9
Machinery and Equipment Expenditures (% growth)	8.8	2.8	-5.9	1.0	-5.3	-13.5	-4.8				-2.7	-0.9
Pre-Tax Corporate Profits (% growth)	23.1	-9.5	6.5	4.8	-61.7	-20.8	16.1				-15.5	3.9
Industrial Production (% growth)	4.8	0.0	2.2	4.0	-4.7	-9.7	6.1		Oct	-0.1	-1.7	1.4
Industrial Product Prices (% growth)	7.0	1.0	0.5	2.5	-0.4	1.8	3.7		Nov	-0.2	-0.7	2.3
Non-Residential Construction (% growth)	15.9	12.4	7.8	-0.4	-24.7	-9.3	-6.5					
Housing Starts (' 000 units)	193	215	188	189	175	193	213		Nov	212	191	182
Personal Expenditures (% growth)	2.2	1.9	2.4	2.6	0.4	2.3	1.8				1.9	1.9
Consumer Price (% growth)	2.9	1.5	0.9	2.0	0.0	4.9	1.3		Nov	-0.1	1.1	1.9
Employment (% growth)	1.5	1.3	1.4	0.6	0.7	0.8	0.8	0.9	Dec	0.1		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7	6.8	7.0	7.1	Dec	7.1	6.9	6.9
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4	60.2	57.0	57.8	Dec	55.7		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9	57.8	58.2	57.2	Dec	53.4		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.

Share your opinion and help improve the Canadian business ecosystem.

APPLY NOW >